

OPTIONS CONSULTING

Silicon Valley – Greater Bay Area (925) 833-1410 www.tp-options.com

Letter of Comment No: 605 File Reference: 1101-SCU Date Received: 09 14 03

September 14, 2003

Ms. Wendy Metcaffe Assistant Project Manager Financial Accounting Standards Bd 401 Merritt 7, Norwalk, Connecticut Ms. Kimberley Crook Project Manager Int'l Accounting Standards Board 30 Cannon Street, London

By Electronic Mail

Re: Stock-Based Compensation Projects (FASB Ref. No. 1101-SCU)

Dear Ms. Metcaffe and Ms. Crook:

I am pleased to submit the attached comments on accounting for stock-based compensation on behalf of Transfer Pricing Options Consulting (TPOC) for consideration by both the FASB and the IASB. We trust that you will distribute these comments to your respective Boards as well as other interested parties (including the Option Valuation Group). We would be delighted if these Comments prove useful or informative in advance of the IASB's meeting later this week.

TPOC broadly approves of expensing of stock-based compensation, and is preparing detailed comments on several sub-issues. Part I of our Comments, "Improving the Accuracy and Comparability of Option Pricing Models," was submitted to the FASB on July 6, 2003. The attached document, Part II of our Comments, is titled "Accounting for Performance Conditions / Disclosures."

In general, we were pleased with the direction taken by the FASB at their meeting last week on the project. In particular, we applaud the movement away from a simple-minded application of the Black-Scholes formula using the flawed "expected life" convention, and towards dynamic modeling of employee exercise patterns. This is a major step toward improving the accuracy of option models — especially for high-volatility options, which conventional models systematically overvalue.

Although TPOC continues to advocate a simplified binomial approach (using a fixed and disclosed "expected exercise threshold") for the sake of verifiability and



comparability, we fully understand the FASB's desire for flexibility and respect the Board's hesitance to create overly prescriptive rules.¹

Our current comments address a significant, but so far overlooked, danger in the direction the Boards are heading with regard to performance conditions. The IASB has backed away from "pure" grant-date accounting due to the difficulty of determining the proper discount for performance conditions and the related risk of manipulating financial results by intentional overvaluation. We believe that this decision is fundamentally sound.

What we fear has been overlooked is an entirely different risk that arises under the modified grant-date rules of FAS 123. The risk is that performance conditions may be manipulated to avoid recognizing any expense whenever an option grant goes "underwater." This type of abuse has not become evident yet because most companies continue to apply intrinsic value accounting under APB 25, and do avoid use of performance conditions for fear of variable accounting.

Our comments suggest a solution to this problem that is both feasible and conceptually sound: a "hybrid" approach to stock option accounting that mixes elements of the "pure" and "modified" grant-date approaches considered by the Boards to date.

We hope that these comments help with these important projects. Please feel free to call the undersigned at 1-925-833-1410 to discuss these or related issues.

Sincerely.

2 DASACALLS

David G. Chamberlain Principal, Transfer Pricing Options Consulting

Date: 2003.09.14

¹ In this regard, assuming the final standards provide wide flexibility to preparers, while we approve of guidance that discourages simple-minded use of the Black Scholes formula, we urge the Boards not to dismiss closed-form alternatives to tree or lattice-based pricing approaches. In particular, we note that an elegant closed-form approach to capture the effect of employee exercise patterns was already developed by Peter Carr and Vadim Linetsky a few years ago. See P. Carr and V. Linetsky, "The Valuation of Executive Stock Options in an Intensity-Based Framework," EUROPEAN FINANCE REVIEW 4 (2000) 211-230.

Comments on FASB Stock-Based Compensation Project

Part II: Accounting for Performance Conditions / Disclosures

Transfer Pricing Options Consulting



www.tp-options.com Silicon Valley, California (925) 833-1410

Table of Contents

PART II: ACCOUNTING FOR PERFORMANCE CONDITIONS	
A. Introduction	
B. BACKGROUND AND HISTORY	
C. Considerations	
i) Grant vs. Vesting Date	
ii) Discounting vs. Non-recognition	4
D. RECOMMENDATIONS	4
i) Service Based and Price Based Conditions	4
ii) Valuing of Performance Condition Discounts	
iii) Recommended Methodology	7
E. DISCLOSURE RECOMMENDATIONS	8
i) Disclosure Recommendations	8
ii)Example	
A PPENDIX A – BACKGROUND ON TPOC AND ITS PRACTICE (CON FROM APPENDIX A OF PART I)	
A. BACKGROUND AND INTEREST	1
B. TRAINING AND EXPERIENCE OF TPOC TEAM	
C. TPOC'S MISSION	9

Comments on FASB Stock-Based Compensation Project

Part II: Accounting for Performance Conditions

A. Introduction

- 4.01 Transfer Pricing Options Consulting (TPOC) provides tax advice on setting and documenting transfer prices for goods, services and other transactions in compliance with the international arm's length principle. See Appendix A for further background on TPOC. Our interest in accounting standards derives both from being users of financial statements and from providing tax advice to companies that prepare them. TPOC broadly approves of fair value expensing of employee options, and is preparing detailed comments for the FASB/IASB projects. Part I discussed option pricing models; later Parts will cover income tax effects. The current document (Part II) chiefly addresses accounting for employee stock option grants with various types of vesting conditions, and also discusses disclosure requirements.
- 4.02 Twin Perils. To date, two competing approaches have been proffered: (1) the "pure" grantdate approach values stock options entirely on grant date, including a discount for vesting conditions, and recognizes the value as expense over the vesting period; (2) the "modified" grant-date approach also values options as of grant date, but allows no discount for vesting conditions and instead makes recognition of the expense conditional on actual vesting. Despite its conceptual merits, the pure approach has been rejected because it creates an incentive to overvalue the vesting-condition discount (valuation peril). In our view, the twin peril facing the modified approach has been given inadequate attention: namely, the incentive to structure conditions so as to avoid recognizing any expense for underwater options (structuring peril).
- 4.03 Recommendations. Both the pure and modified approaches rightly reflect the fact that vesting conditions can only reduce amount of expense, one by discounting and one by conditional recognition; however, the twin perils can both be avoided only by crafting a "hybrid"* approach. To reduce structuring peril, accounting standards should require some expense to be recognized in all cases after all, even an option burdened with severe conditions has some value at grant date. Although a value must be placed on the vesting-condition discount, valuation peril can be minimized by applying the modified grant-date approach to the discount itself: that is, the final accounting standard should provide that the vesting-condition discount is recognized as an expense only if the options fail to vest.

*Note: Although we use the "hybrid" label in this paper to distinguish the recommended approach from the "pure" and "modified" grant date approaches as currently understood, we do not intend for this label to stick permanently. The recommended approach is really just a refinement on the modified grant date approach.

B. Background and History

- 4.04 One of the key goals of accounting standards is "neutrality": the standard should neither encourage nor discourage any particular business practice or activity, but should reflect the financial results of such activity fairly and accurately. Accounting Principles Board Opinion No. 25 ("APB 25"), adopted in October, 1972, is widely thought to have failed to achieve neutrality with respect toperformance conditions and other aspects of plan design.
- 4.05 In practice, APB 25 has had the effect of discouraging use of vesting conditions other than those based on continued employment for a fixed period of time (so called "service-based conditions"). Other conditions, such as meeting individual performance goals or outperforming industry benchmarks, (so-called "performance-based conditions") have been rarely used because they result in "variable" accounting, where the measurement date is deferred until the performance condition is met. Even though vesting conditions reduce the value of a stock option grant, the amount of expense ultimately recognized under APB 25 for a grant with performance conditions can be much greater than the amount recognized for an otherwise identical grant without them.
- 4.06 The anomalous treatment of "fixed" versus "variable" option plans was one of the chief reasons why the FASB took up accounting for stock options again in the early 1990s. Under the fair value method of Financial Accounting Statement No. 123 (FAS 123), the distinction between fixed and variable plans is eliminated and grant date is the measurement date for all employee stock options. The FAS 123 method is known as a "modified" grant-date method because, although the amount of expense is measured on grant date, the expense is not recognized unless the option actually vests.
- 4.07 In exposure draft no. 2 of the proposed IFRS "Share-based Payment," issued in November 2002, the IASB proposed a "pure" grant-date approach as the best measure of the value of the employee services to be provided. After receiving comments, the IASB has tentatively agreed to follow the "modified" grant-date approach instead "for practical reasons" such as the difficulties (and risks of manipulation) in valuing performance condition discounts.
- 4.08 Although the FAS 123 modified grant-date approach has been available since 1995, it remains largely untested because most companies have elected to continue to follow APB 25. As a result, any risks of manipulating performance conditions to avoid expensing have not become apparent. As

explained fully in discussion of intrinsic vs. extrinsic conditions below, we believe this risk is quite significant.

C. Considerations

i) Grant vs. Vesting Date

- 4.09 The "pure" and "modified" grant-date approaches each have a conceptual basis. Grant date is the date that the employer and the employee effectively reach agreement on the terms of employment and compensation. Therefore, it is reasonable to use expected value on grant date as the measure of the bargained for exchange.
- 4.10 Vesting date is the date that the employment contract is fulfilled. After vesting, employees stand in the same position as outside investors with similar rights and are free to treat their stock options like any other investment. Before vesting, on the other hand, employee stock options serve significant motivation and retention purposes; changes in option value are one factor motivating employee to continue employment or consider leaving. Nonetheless, vesting date or service period approaches to option accounting would not be appropriate because they result in excessive volatility in compensation expense not reflective of fact that option value is just one of many motivating factors.
- 4.11 Modified grant-date accounting reflects the significance of vesting without excessive volatility. It is less volatile than service period accounting because option value is determined at grant-date, but is more volatile than "pure" grant-date accounting on both the up side (no discount for conditions) and the down side (no expense recognized for options that do not vest).
- 4.12 The recommended "hybrid" method reflects an intuitive extension of these concepts. Recognizing no expense whatsoever if performance conditions fail (as under FAS 123) seems inconsistent with the motivational value of the options; that is, the employee's expectations about the possibility of achieving the conditions are part of the bargained-for-exchange on grant date. Under the recommended hybrid method, some amount of expense would be recognized for all grants: specifically, the value of the option grant, reduced by the performance condition discount. The value of the performance-condition discount would effectively be treated akin to a performance bonus, recognized only if vesting conditions are met.

ii) Discounting vs. Nonrecognition

4.13 Another perspective is to consider discounting under the "pure" grant-date method and non-recognition under the "modified" method as an implicit trade-off. Both methods properly reflect that performance conditions can only reduce the value of otherwise equivalent grants, but do so in different ways. For argument's sake only, consider if companies were allowed to elect either method: the "better" choice is <u>not</u> obvious a priori—the company would have to choose between the certainty of reducing expense by the value of the performance condition or the possibility of not recognizing any expense at all if the performance condition fails to be achieved.

D. Recommendations

i) Service-Based and Price-Based Conditions

- 4.14 Currently, modified grantdate accounting applies to both performance-based and service-based conditions. Option pricing experts have suggested that service-based conditions could be incorporated into accepted option pricing models very easily and accurately. Moreover, employee turnover assumptions used in the models could easily be disclosed at the grant date; and deviations between assumed and actual turnover rates could be disclosed (with or without true-up to recorded option expense) at vesting dates or other intervals.
- 4.15 TPOC recommends that service-based conditions (like price-based conditions see next paragraph) be incorporated into the grant-date value rather than being subject to modified grant-date accounting. There are several reasons to do so: (i) simplicity it is easier to incorporate such features in the pricing model than to calculate a separate discount for the condition; (ii) objectivity anyone using the same model will get the same valuations; and (iii) conceptual purity TPOC prefers "pure" grant-date accounting as a conceptual matter and, like the IASB, supports a "modified" grant-date method chiefly "for practical reasons."
- 4.16 Understandably, some FASB members have expressed reluctance to distinguish between types of conditions. However, it must be recognized that some distinctions are necessary at least under the modified grant date approach as currently understood. For example, paragraph 26 of FAS 123 ignores conditions that are based on "target stock price or specified amount of intrinsic value on which vesting or exercisability is conditioned." The distinction between price based conditions and true performance conditions is

clearly necessary: otherwise, companies could avoid expensing of underwater options simply by adding an explicit price-based condition.

- 4.17 To prevent manipulation of modified grant-date accounting under current rules, the distinction in FAS 123 paragraph 26 should be expanded to cover conditions that are strongly correlated with price. For example, if a company knows there is a high correlation between its stock price and maintaining its market share, then management could simply place an easily achievable market-share condition on option grants to reduce the likelihood of having to recognize expense if the options go underwater. Unfortunately, this sort of anti-abuse rule would, in effect, create a treatment alternative for borderline cases: if a condition is characterized as "strongly correlated" with price, the condition is ignored and "pure" grant-date accounting essentially applies if it is characterized as a "true" performance condition, then the grant itself is potentially ignored under modified grant-date accounting rules (i.e., if the condition fails to be met, no expense is recognized).
- 4.18 Under the proposed "hybrid" approach, an expanded definition of price-based conditions would <u>not</u> be necessary and, therefore, no treatment alternatives would be created. The potential for abusing performance conditions that are correlated with price would be greatly tempered by the requirement that performance conditions be separately valued. First, since an easily achievable performance condition would have a relatively low value, the potential reduction of recognized stock-based compensation expense would be minimized. Second, required grant-date disclosure of the terms and value of the performance condition should discourage manipulating the valuation itself.
- 4.19 As noted earlier, the potential abuse of performance conditions has not yet surfaced in practice because most companies continue to follow APB 25, and avoid performance conditions for fear of variable accounting. Nonetheless, given the stakes, some abuse seems inevitable once expensing becomes mandatory if the rules and guidance of FAS 123 remain unchanged. Either the expanded definition of price-based conditions or the hybrid approach to modified grant-date accounting will prove necessary. If the issue is not addressed in the revised standard itself, later interpretative guidance will likely be needed. At that time, only anti-abuse rules making fine distinctions between price-based condition and true performance conditions will be possible. We believe that the proposed "hybrid" approach to modified grant-date accounting is conceptually superior, and that the marginal complexity it adds to the stock-based compensation standardis well worthwhile.

ii) Valuing of Performance-Condition Discounts

- 4.20 We do not mean to suggest that the valuation of performance-condition discounts is simple or non-controversial. We agree that the difficulty of valuing the discount and the risk of intentional overvaluation are sufficient reasons to reject "pure" grant-date accounting. Nonetheless, we consider any attempted valuation of the discount to be more accurate and less subject to manipulation than the rule of FAS 123 that disregards the option grant altogether if a performance condition fails to be met. We believe that the best solution is the proposed "hybrid" method, which calls for valuation, disclosure and conditional non recognition of expense equal to the performance-condition discount
- 4.21 While rough estimates may be possible, the conceptually rigorous way to value the performance condition discount involves comprehensive binomial modeling. It would not be adequate to simply estimate the probability of the condition being met, and then use this as a percentage haircut to the value of an unconditional option grant because some correlation (strong or weak) can always be expected between the performance condition and the underlying stock price.
- 4.22 We do not describe the valuation methodology in detail here, but leave it to others to flesh out. In skeletal outline: first, build a binomial tree (or other model) to value the option grant, ignoring the performance condition; second, carve out a "subtree" discounting probabilities at each node to reflect the combined likelihood of reaching the node and the performance condition being met; third, calculate the performance condition discount as the difference in value between the two binomial trees.
- 4.23 The second step, in particular, requires a high degree of subjective judgment on the part of management. Modeling performance conditions is, therefore, quite different from building expected forfeitures into a binomial model based on simple assumptions about employee turnover rates. Indeed, since nodes on a binomial tree are defined as a function of time and price, both service-based and price-based conditions are most naturally reflected in the initial binomial tree and accounted for on a "pure" grant-date basis
- 4.24 For these reasons, we recommend that final accounting standards differentiate between service-based/time-based conditions, on the one hand, and true performance conditions, on the other. However, even if the FASB decides to retain modified grant date accounting for service-based conditions, the "hybrid" method could (and, we believe, should) still be adopted.

iii) Recommended Methodology

- 4.25 In summary, TPOC recommends the following step-by-step approach to accounting for performance conditions:
 - O Determine inputs as under FAS 123, these include stock price, strike price, volatility, expected interest rate and dividends If TPOC's recommendations are fully adopted, then "expected life" from FAS 123 would be replaced with vesting period (see ¶ 4.23 below), expected forfeiture rate and expected exercise threshold.
 - Apply model to derive gross value of option grant incorporating service-based and price-based conditions, but ignoring true performance conditions.
 - Value discount for performance conditions using "with and without" analysis base on binomial models.
 - o Disclose inputs and valuations in quarterly report following grant.
 - Recognize net value of option grant (gross value of grant less discount for extrinsic performance conditions) as expense over the vesting period.
 - Recognize value of extrinsic performance condition discount as expense over remaining vesting period when (and if) it appears probable that the condition will be satisfied.
 - Reverse prior cumulative expense for performance condition discount when (and if) it no longer appears probable that the condition will be satisfied.
- 4.26 Vesting period plays a key role here, both for applying the option pricing model and for recognizing expense. For service-based conditions, the vesting period is obvious and straightforward. For a true performance condition (i.e., extrinsic condition), the vesting period may have to be estimated or inferred. For example, if the performance condition is the achievement of specified net operating profits for the following two years, a two year vesting period can be easily inferred. On the other hand, if the condition is achieving specified targets for two consecutive years, the company may have to estimate the earliest period over which the goal could realistically be achieved.

4.27 A basic example of the recommended approach is provided in the following section. More complex cases can be resolved with similar principles. For example, consider a case where the exercise price varies depending on market share. The company should determine (and disclose) grant date values for the full grant and the performance condition discount based on each possible outcome, but only recognize expense from time to time based on the outcome deemed to be most probable.

E. Disclosure Recommendations

i) Disclosure Recommendations

4.28 As for disclosure requirements, we recommend a relatively high level of detail for stock-based compensation. We believe that the benefits to users of financial statements—and the perceived integrity of the financial accounting system itself—outweigh the increased burden on preparers. Some users may hold fast to the view that "stock-based expense" is an oxymoron, and look for pro forma disclosures that disregard it. Other users may have their own views on the most reliable way to measure option expense, and seek additional data to make adjustments. Finally, some users may simply be suspicious of management's reporting in this area; transparency is the best antidote.

4.29 We would like to comment on three specific aspects of disclosure:

Income statement Each expense item in the current-period income statement (e.g., cost of goods sold, sales and administration, research and development, income taxes) should be shown with and without stockbased compensation expense. (Note: the "without" figures should exclude expense entirely, not be based on intrinsic value principles like APB 25.)

Grant date valuations. Detailed information on each grant of employee stock options should be provided in footnotes. Recommended data items are described in the following section and illustrated in Exhibit 1 below. Each quarterly financial report should include up to date information on all option grants that remain unvested (in whole or in part). Sums or weighted averages of the data items could also be provided, but should (unlike current FAS 123 rules) should not be sufficient.

Actuals vs. expectations. Material differences between grantdate assumptions and actual results should be disclosed in footnotes. For example, disclosure should be required if an 8% forfeiture rate is assumed, but actual pre-vesting forfeitures run at 16% (or 4%).

ii) Example

4.30 Finally, let us provide an example of the "hybrid" approach to modified grant-date accounting —together with an illustration of recommended grant-by-grant disclosures. The example involves a grant of employee options on 1,000 shares of company stock by a calendar year company on January 1, 2004 (assuming the earliest conceivable effective date for revised FASB standards). The underlying facts of the grant are consistent with the examples in Part I of TPOC's Comments:

Stock price and strike price: \$10.00 (an at-the-money grant)

Overall term: 10 years

Vesting: 2 year step vesting (50% vest at first year end, 50% at second)

Volatility: 60% Interest rate: 5%

Expected annual employee turnover rate (forfeiture): 8%

Expected exercise threshold (i.e., when most employees will exercise vested options): 150% of strike price (i.e., \$15)

As reported in Part I of TPOC's Comments, the expected value of each option in this grant is \$3.66 (taking into account expected forfeitures). Therefore, the expected stock-based compensation expense over the two year vesting period would be \$3,660 (\$3.66 x 1000 shares). Given the vesting schedule, 75% of this expense is frontloaded into the first year (100% of the first year tranche plus 50% of the second year tranche).

4.31 Assume further that this grant is subject to a performance condition based on the corporation obtaining regulatory approval for a particular product by the end of the first year (2004). Applying appropriate judgment and analysis, the company estimates that this performance condition reduces the value of the grant by one-third and, thus, arrives at a value of \$1,220 for the performance condition discount. At the end of the first quarter, management cannot say that meeting the performance condition is "probable"; by the end of the second quarter, positive developments lead management to conclude that it has become probable; after reversals of fortune in the third quarter, management again changes its assessment; but, by the end of the year, the company pulls through and obtains regulatory approval after all:

4.32 Exhibit 1 illustrates the "hybrid" method of accounting and recommended quarterly disclosures over the two year vesting period of the grant. For each outstanding grant (other than grants that were wholly vested and fully expensed prior to the start of the annual reporting period), the following four groups of data would be disclosed. If different assumptions are used for different groups of employees, each group should be disclosed as a separate sub-grant.

4.33 Basic grant information includes

- o Grant date
- o Number of shares subject underlying options
- o Grant-date stock price
- o Option strike price
- o Full term of options

Basic grant information would not ordinarily change from one quarterly report to the next.

4.34 Grant-date assumptions include:

- Vesting period period of service-based conditions or expected vesting period of performance-based conditions
- Risk-free rate expected risk-free rate over life of option
- Volatility expected volatility of underlying stock
- Forfeiture rate expected rate of employee turnover, resulting in forfeiture (before vesting) or forced exercise (after vesting)
- Exercise threshold percentage of strike price at which the typical employee is expected to exercise vested options (as described in Part I of TPOC's Comments)

If flexible binomial modeling is allowed by the final standard, each of the grant-date assumptions may be a schedule or range of values rather than a single figure. Grant-date assumptions should not change from one quarterly report to the next, but material difference between the assumptions and actual results should be disclosed.

4.35 Grant-date valuations include:

- Per-share value generally, the output of an option pricing model, reflecting service based and price based conditions, but ignoring performance based conditions
- o Gross value of grant per-share value times number of shares underlying grant
- Performance condition value derived for performance-condition discount (if any)
- Net value of grant gross value of grant less performance condition discount (amount to be recognized as expense over vesting period irregardless of the outcome of the performance condition)

Grant-date valuations should not change from one quarterly report to the next except in connection with a full-fledged restatement.

4.36 Current period expense and related disclosures include:

- Basic grant expense amortization of net value of grant over vesting period(s)
- Performance condition zero (or reversal of cumulative expense) if meeting the performance condition is not "probable"; amortization of the performance-condition discount over the remaining vesting period if it is probable
- Total stock based compensation the sum of basic grant expense and performance condition expense for the current period (reconcilable with stock based compensation disclosed on income statement for the period)
- o Remaining amount of net grant difference between grant-date net value of grant and cumulative basic grant expense
- Remaining amount of performance condition difference between grant-date value of performance-condition discount and cumulative recognized performance condition expense

In Exhibit 1, note the following: basic grant expense is greater in first year due to step-vesting; one third of performance condition is recognized in second quarter, reversed in the third quarter and then the full performance condition discount is recognized at the end of the year when the condition is satisfied and the options fully vested.

EXHIBIT 1. RECOMMENDED DISCLOSURES

Basic Grant Information	Grant-Date Assumptions	Grant-Date Valuations	Current Period E	Expense Remail	ning Amount
					A STATE OF THE STA
Quarter Ending 3/31/2004:	1	ı I		1	
A. 1/1/2004 1000 \$10 \$10 10 yrs	1-2 yrs 5.0% 60% 8% 150%	\$3.66 \$3,660 \$1,220 \$2,440	\$458 \$0	\$458 \$1,98	3 \$1,220
	•		04.		
		Quarter Ending 6/30/20	\$458 \$407	7 \$864 \$1,52	5 \$813
		Quarter Ending 9/30/20	<i>04:</i> \$4 58 (\$407	7) \$51 \$1,06	8 \$1,220
		Quarter Ending 12/31/2	<i>004</i> : \$458 \$1,220	D \$1,678 \$61	0 \$0
		Quarter Ending 3/31/20	05: \$153 \$0	D \$153 \$45	8 \$0
		Quarter Ending 6/30/20			
		Quarter Ending 9/30/20	05:		
		Querter Ending 12/31/2			

Appendix A – Background on TPOC and Its Practice (condensed from Appendix A of Part I)

A. Background and Interest

Transfer Pricing Options Consulting (TPOC) provides advice to multinational corporations, national tax authorities and other interested parties with respect to intergroup transfer pricing and related tax obligations. In particular, we advise clients on how to set and document transfer prices for goods, services and other transactions in compliance with the internationally accepted arm's length principle. TPOC's interest in the issue of accounting for employee stock options derives both from being users of financial statements and from providing tax advice to companies that prepare them.

Consulting on arm's length transfer pricing requires TPOC to collect and analyze financial statements and other information from public companies around the world. In this regard, TPOC is deeply interested in consistency among national accounting standards, accuracy in measurement of financial items, and full disclosure of methods and assumptions. As a matter of international tax policy, TPOC strongly believes that the treatment of employee stock options for intergroup transfer pricing purposes should be based on solid economic theory, be consistent among tax jurisdictions and conform to principled accounting standards.

B. Training and Experience of TPOC Team

David Chamberlain, J.D., LL.M., is founder and principal of TPOC. David earned his J.D. (Juris Doctor) from Columbia University (New York City) in 1992; and his LL.M. (Master of Law) in Taxation from New York University in 1993. David has nearly ten years of experience in the international tax and transfer pricing practice of PricewaterhouseCoopers in San Francisco and San Jose, where he worked extensively with clients setting up and maintaining R&D cost sharing arrangements. David led a number of policy oriented projects on stock options and cost sharing, and has coauthored several articles on the subject. David has prior experience in database programming for the health care industry.

Daniel Asquith, Ph.D., is senior economic advisor to TPOC. Dan earned his Ph.D. in Business Economics from the University of California at Los Angeles in 1992. Dan has over 15 years of professional experience in academia, government and consulting. Dan's early experience includes being a visiting assistant finance professor at Tulane University and a staff economist with the Securities and Exchange Commission (SEC). For the past nine years, Dan has specialized in transfer pricing, including several years with the Internal Revenue Service (IRS) and five years with major public accounting firms. Dan currently provides independent consulting services in transfer pricing and valuation, specializing in intangible property transfers and cost sharing.

TPOC works with a loose coalition of independent transfer pricing and valuation consultants from various disciplines and specialties, spanning the West Coast from Seattle to Los Angeles. TPOC is able to draw on the coalition for special expertise, as well as language skills, with respect to many geographic regions and practice areas.

In preparing these Comments, TPOC has received invaluable assistance and inspiration from many friends and colleagues. Responsibility for all errors and omissions rests entirely with TPOC.

C. TPOC's Mission

TPOC's founding mission is to seek comprehensive resolution of the accounting and transfer pricing issues relating to employee stock options as quickly as possible. As comprehensive resolution requires formation of a high level of consensus on an international basis, a key part of TPOC's agenda is to provide comments and advice to relevant policy-makers, including the FASB, the IASB, the U.S. Treasury, the IRS and the OECD.

As a small and highly specialized enterprise, TPOC has a unique opportunity to be a completely independent voice, free from the vested interests of taxpayers, tax authorities, lawyers, accountants and financial consultants. TPOC's long-term mission is to provide high-quality transfer pricing advisory services, not to sell proprietary option pricing models. Our immediate goal is to assure that the best thinking in the area of accounting for employee stock options remains firmly in the public domain.